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TAX LAW

I. CONTRACT RENTAL VALUE IS INCLUDED IN PROPERTY VALUATION FOR *Ad Valorem* TAX ASSESSMENT

In *South Carolina Tax Commission v. South Carolina Tax Board of Review*¹ the South Carolina Court of Appeals ruled upon the novel issue of what factors are determinative in the valuation of property for *ad valorem* tax purposes. In holding that the contract rental value of a lease is one of the determinative factors of the market value of property,² the court of appeals places South Carolina in accordance with the majority of other jurisdictions.

The controversy in this case arose over the effect given to a long-term lease in the determination of property values for *ad valorem* tax assessment. The respondent, a general partnership, owned an office building in Columbia, South Carolina, and leased approximately sixty-one percent of the building's available space to Southern Bell under several long-term leases.³ Pursuant to statute,⁴ the petitioner, South Carolina Tax Commission, initially appraised the value of the property, for tax purposes, at \$2,330,000. This appraisal placed no value upon the leases or contract rents that were derived from the property.⁵ Following an administrative hearing and subsequent appeal to the Tax Board of Review, the Tax Board fixed the fair market value at \$1,596,500.⁶ The Tax Commission appealed the decision to the Richland County Court of Common Pleas and to the South Carolina Court of Appeals. Both courts affirmed the decision of the Tax Board.

The decision of the court of appeals centered on defining

1. 287 S.C. 415, 339 S.E.2d 131 (Ct. App. 1985).

2. *Id.* at 419, 339 S.E.2d at 133.

3. Record at 5.

4. S.C. CODE ANN. §§ 12-3-140(7), 12-43-220(a) (1976 & Supp. 1985).

5. Record at 1.

6. 287 S.C. at 417, 339 S.E.2d at 132. This valuation considered the fair market value in light of the leases encumbering the property.

terms contained in South Carolina Code section 12-37-930,⁷ which deals with property valuation. This statute requires that the tax value of property shall be the property's "true value in money," defined as "the market value between a willing buyer and seller."⁸ The court defined market value as being the same for tax purposes as for sales purposes.⁹ Because purchasers or investors would consider a long-term lease and the rents accruing under this lease when valuing property for sales or investment purposes, the court held that for income-producing commercial real estate, a lease and the actual income to be derived under this lease should be a determinative factor in assessing tax value.

In defining factors determinative of market value, the court of appeals addressed an issue never before directly answered by the courts in South Carolina. Article X, section 3(a) of the South Carolina Constitution states that "all property . . . shall be taxed in proportion to its value."¹⁰ Taxes, however, must be laid, not upon the property itself, but upon the actual value of the property as ascertained by an assessment for tax purposes.¹¹ Only a few cases have dealt with factors that determine value for purposes of taxation.¹² Although relevant factors have been held to be mandatory for consideration of actual value,¹³ these relevant factors have not been defined previously.¹⁴

Although no South Carolina case has dealt with the issue of rental value affecting tax valuation, other jurisdictions that have

7. S.C. CODE ANN. § 12-37-930 (Supp. 1985).

8. 287 S.C. at 419, 339 S.E.2d at 133. Section 12-37-930 also requires that neither party act under compulsion and that they be "reasonably well informed" of the present and potential uses of the property. S.C. CODE ANN. § 12-37-930 (Supp. 1985).

9. 287 S.C. at 419, 339 S.E.2d at 133.

10. S.C. CONST. art. X, § 3(a). Although this section of the Constitution is not cited by the court, it is often cited in other cases dealing with tax valuation. See, e.g., S.C. Tax Comm'n v. S.C. Tax Bd., 278 S.C. 556, 299 S.E.2d 489 (1983); Meredith v. Elliott, 247 S.C. 335, 147 S.E.2d 244 (1966).

11. State v. Cheraw & D.R.R., 54 S.C. 564, 32 S.E. 691 (1898).

12. One factor contributing to the lack of judicial decision is found in the Administrative Procedures Act, S.C. CODE ANN. § 1-23-380(f) (Supp. 1985), which confines review of administrative decisions, like those of the Tax Board, to the record developed in the administrative hearings.

13. S.C. Tax Comm'n v. S.C. Tax Bd., 278 S.C. at 561, 299 S.E.2d at 492.

14. A lease is a factor to be considered in determination of value for *ad valorem* taxes. 1969 Op. S.C. Att'y Gen. 4, No. 2610. No South Carolina case, however, is cited by the Attorney General to support this proposition.

addressed this issue generally agree that actual or potential income from a lease will affect market value and, therefore, should be considered in tax valuation.¹⁵ Some disagreement, however, arises over whether actual income from rents or potential income capacity of the property should be used to determine tax value. By holding that the actual, and not the potential, value of a lease is one of the determinative factors, the court of appeals has placed South Carolina in accordance with a plurality of other states.¹⁶ Like the *South Carolina Tax Board* court, several states also recognize that the capitalization of income method is relevant in the determination of value for tax purposes.¹⁷

The decision of the court of appeals in this case brought clarity to the issue of *ad valorem* tax valuation. Upon rehearing, however, the court unfortunately broke away from taxation issues and viewed the controversy as arising over "the weight of the evidence."¹⁸ Although this may seem to weaken the impact of the decision, the court specifically stated that the existence of a lease and the consideration deriving from this lease is "an element to be considered" for valuation purposes.¹⁹ This reemphasizes the original decision. Because the decision was affirmed, the attempt to change the focus from tax issues to evidentiary issues should not affect the impact of this decision upon South Carolina law.

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II. SITUS OF COPYRIGHTS DETERMINED

In *Pendarvis v. South Carolina Tax Commission*²⁰ the South Carolina Supreme Court held that the price of a copy-

15. See generally Annotation, *Income or Rental Value as a Factor in Evaluation of Real Property for Purposes of Taxation*, 96 A.L.R.2d 666 (1964).

16. See *id.* Twenty-four states have held that actual income from rents is a factor, twenty-three have held that potential value should be considered, and nine states have ruled both ways.

17. See, e.g., *Bornstein v. State Comm'n*, 227 Md. 331, 176 A.2d 859 (1962); *People ex rel. Parklin Operating Corp. v. Miller*, 287 N.Y. 126, 38 N.E.2d 465 (1941).

18. 287 S.C. at 421, 339 S.E.2d at 134.

19. *Id.* at 421, 339 S.E.2d at 134. The original decision held this to be a determinative factor. *Id.* at 419, 339 S.E.2d at 133.

20. 285 S.C. 381, 329 S.E.2d 766 (1985).

righted motion picture could be amortized and deducted in South Carolina although the film itself was never physically present within the State. In so holding, the court adopted the general rule regarding the situs of intangibles.²¹

Pendarvis purchased the copyrights to two motion pictures for investment purposes and immediately granted an exclusive license to an out-of-state distributor in exchange for a percentage of the royalties.²² Although Pendarvis had full ownership of the films and the copyrights in South Carolina, neither the motion pictures nor copies of them were used or physically located in South Carolina during 1977. Pendarvis sought to take a depreciation deduction for the movies on his 1977 tax return. The Tax Commission disallowed the deduction characterizing it as an ordinary business loss from an out-of-state business activity rather than an amortization of a capital asset.²³

In rendering its opinion, the supreme court reasoned that a copyright is intangible property, entirely distinct from the tangible object it protects,²⁴ and that "[t]he situs of a copyright is the domicile of its holder."²⁵ Based upon these observations and a characterization of the copyright as a capital asset,²⁶ the court ruled that the deduction was properly taken in South Carolina.²⁷

In *Seward v. South Carolina Tax Commission*²⁸ the supreme court had announced the standard that losses generated by investment activity could not be deducted in South Carolina unless gain from such activity would be taxable in South Carolina.²⁹ Prior to 1977, statutory law would have allocated any income generated by the copyright to South Carolina.³⁰ Therefore,

21. 71 AM. JUR. 2d *State and Local Taxation* § 666 (1973).

22. Record at 7.

23. 285 S.C. at 382-83, 329 S.E.2d at 767.

24. *Id.* at 383, 329 S.E.2d at 767.

25. *Id.*

26. *Id.*

27. *Id.* at 383, 329 S.E.2d at 768.

28. 269 S.C. 52, 236 S.E.2d 198 (1977).

29. *Id.* at 58, 236 S.E.2d at 200.

30. S.C. CODE ANN. § 12-7-1120(3) (1976) allocated to South Carolina royalties from copyrights "(a) [i]f and to the extent that the . . . copyright is utilized by the taxpayer in this State, or (b) [i]f and to the extent that the . . . copyright is utilized by the taxpayer in a state in which the taxpayer is not taxable and the . . . individual taxpayer's domicile is in this State." The statute further provided that "[i]f the basis of receipts from copyright royalties does not permit allocation to states or if the accounting procedures do not reflect state of utilization, the copyright is utilized in the state in which . . .

under *Seward* the deduction would have met with little or no resistance. However, the *Seward* standard was deleted from the tax code in a move designed to "further allow apportionment of income to this state,"³¹ leaving sections dealing with interest received from intangible property³² and gains or losses from sales of intangible property.³³ Neither of these sections applied since *Pendarvis* dealt with royalties. Without the language of the pre-1977 tax law, the court reached the same result by relying upon the common-law notion that the situs of a copyright is the domicile of its holder.³⁴

In holding that the cost of a copyrighted film may be depreciated by a South Carolina taxpayer, the supreme court clarified an area of law that is particularly confusing. Because of the brevity of the court's opinion, however, it may be desirable for the legislature to adopt language clearly defining the tax consequences for the ownership of copyrighted materials.

Dean A. Eichelberger

III. STATUTORILY CREATED BOARD MAY DENY TAX-EXEMPT STATUS ON CERTAIN CHURCH PROPERTY

The tax-exempt status of an unused portion of church property was the catalytic issue in *Westview Baptist Church v. Rembert*.³⁵ From that issue, two subsidiary issues evolved: The viability of the Charleston County Tax Exempt Board and its authority to revoke exemptions. The court of appeals ruled that the Board was viable and possessed the authority to revoke exemptions and that the Board had correctly exercised that authority in revoking the tax-exempt status of thirteen unused

an individual taxpayer's domicile is located." *Id.* Since Mr. Pendarvis granted an exclusive license to the film distributor in exchange for a percentage of the royalties and those payments would not reflect state of utilization, any gains would be allocated to South Carolina. The practical result under old § 12-7-1120(3) is that there would be a presumption that the situs of the copyright is the holder's domicile.

31. 1977 S.C. Acts 62, No. 49.

32. S.C. CODE ANN. § 12-7-1120(1) (1976 and Supp. 1985).

33. *Id.* § 12-7-1120(5).

34. 285 S.C. at 383, 329 S.E.2d at 767.

35. 286 S.C. 30, 331 S.E.2d 382 (Ct. App. 1985).

acres of Westview property.³⁶

Westview Baptist Church owned seventeen and one-half acres of Charleston County land for which the church had been granted an agricultural use value assessment upon their request. When the church sold the land, Charleston County levied an agricultural roll back tax amounting to \$1900. The church then applied to the Charleston County Tax Exempt Board for complete exemption from property taxes. The Board granted the exemption. Upon discovering that the first hearing had not been conducted in accordance with the Freedom of Information Act,³⁷ the Board held a second hearing despite Westview's objections. The complete exemption, granted a little more than a month earlier, was reduced to an exemption for only four and one-half acres. Westview then appealed to the South Carolina Tax Commission, claiming that the Board had no authority to conduct the second hearing and that the property was exempt. The Tax Commission denied the claims and upheld the Board's decision.³⁸ When the Commission denied the church's request for a rehearing, Westview appealed to the Charleston County Circuit Court. The circuit court affirmed the Tax Commission's decision and Westview then appealed to the South Carolina Court of Appeals.³⁹

The court first addressed the question of the Board's viability, noting that a special act created the Board.⁴⁰ This special act was not repealed by the enactment of section 12-3-145,⁴¹ a general statute that placed the responsibility for making exemptions on the South Carolina Tax Commission. The court then found that Act No. 1489⁴² amended Act No. 494⁴³ and granted revocation of authority to the Board.⁴⁴ It appears that there is no limitation on the frequency of Board review of property status.

36. *Id.* at 31, 331 S.E.2d at 383.

37. S.C. CODE ANN. § 30-4-80 (Supp. 1985).

38. 286 S.C. at 31-32, 331 S.E.2d at 384.

39. Record at 1-2. 286 S.C. at 32, 331 S.E.2d at 382.

40. 286 S.C. at 32, 331 S.E.2d at 384. See 1969 S.C. Acts 857, No. 494 (amended by 1971 S.C. Acts 1089, No. 587; 1972 S.C. Acts 2735, No. 1489; 1976 S.C. Acts 1655, No. 619).

41. S.C. CODE ANN. § 12-3-145 (Supp. 1985).

42. 1972 S.C. Acts 2735, No. 1489.

43. 1969 S.C. Acts 857, No. 494.

44. 286 S.C. at 32, 331 S.E.2d at 384.

Finally, the court upheld the exemption revocation pursuant to South Carolina Code section 12-37-220A,⁴⁵ which limits church property exemptions to portions of land "actually occupied."⁴⁶ Although testimony conflicted, the *Westview* court found it sufficient to support a determination of actual occupation of only four and one-half acres.

The opinion of the court of appeals is logical and concise. As in the past,⁴⁷ the court construes statutes strictly against the taxpayer. The court also provides specific guidelines to churches who find themselves in a similar situation. First, a church must be careful when filing for a certain tax status that the filing is done correctly since a change of an initial decision at a later date may not be an option. It should be noted, however, that since a church primarily received the valuation it originally requested, equity may have been a significant factor in the *Westview* decision. Second, a church should take steps to insure that the requirements set forth in South Carolina Code section 12-37-220 are met.⁴⁸ Exemption statutes will probably continue to be construed strictly against the taxpayer.⁴⁹ Third, a church should raise all potential issues in the lower court. This case might have provided some interesting South Carolina commentary on constitutional law if that issue had been raised at a lower level and preserved on appeal. Last, a church should not look to the courts to remedy confusion that results from the overlapping jurisdiction of statutorily created boards and commissions. Although it may be desirable to eliminate confusion and duplication, it would appear that the legislature, not the courts, must initiate that change.

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45. S.C. CODE ANN. § 12-37-220A (1976 & Supp. 1985). This section was amended in 1978 to exempt all property of all churches from *ad valorem* taxation. 1978 S.C. Acts 1786, No. 621; see S.C. CODE ANN. § 12-37-220A(1) (1976 & Supp. 1985).

46. S.C. CODE ANN. § 12-37-220(8) (1976).

47. *Sharpe v. S.C. Dep't of Mental Health*, 281 S.C. 242, 245, 315 S.E.2d 112, 113 (1984); *Berry v. Weeks*, 279 S.C. 543, 546, 309 S.E.2d 744, 746 (1983); *Strickland v. State*, 276 S.C. 17, 21, 274 S.E.2d 430, 433 (1981).

48. S.C. CODE ANN. § 12-37-220 (1976 & Supp. 1985).

49. *Hibernian Soc'y v. Thomas*, 282 S.C. 465, 319 S.E.2d 339 (Ct. App. 1984).

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